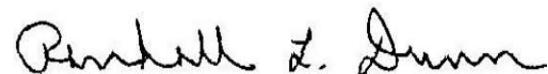


April 15, 2015

Clerk, U.S. Bankruptcy Court

Below is an Opinion of the Court.



RANDALL L. DUNN
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case
MICHAEL W. ENDRESEN,) No. 11-35396-rld7
JOANNE MAUREEN ENDRESEN,)
Debtors.)
STEPHEN P. ARNOT, CHAPTER 7 TRUSTEE,)
Plaintiff,) Adv. Proc. No. 14-3131-rld
v.)
MICHAEL W. ENDRESEN;) MEMORANDUM OPINION
JOANNE MAUREEN ENDRESEN;)
GREEN TREE SERVICING, LLC;)
THE BANK OF NEW YORK MELLON, F/K/A THE)
BANK OF NEW YORK, AS TRUSTEE FOR THE)
HOLDERS OF FIRST HORIZON MORTGAGE PASS-)
THROUGH CERTIFICATES, SERIES FHAMS 2004-)
AA7;)
THE BANK OF NEW YORK MELLON, AS SUCCESSOR)
TO JPMORGAN CHASE BANK, AS TRUSTEE FOR THE)
HOLDERS OF BEAR STEARNS ALT-A TRUST 2005-1)
MORTGAGE PASS-THROUGH CERTIFICATES, SERIES)
2005-1;)
THE BANK OF NEW YORK MELLON, F/K/A THE)
BANK OF NEW YORK, AS TRUSTEE FOR THE)
HOLDERS OF AMERICAN HOME MORTGAGE)
INVESTMENT TRUST 2004-4;)
U.S. BANK NATIONAL ASSOCIATION, AS TRUSTEE)
FOR ADJUSTABLE RATE MORTGAGE TRUST 2005-2,)
ADJUSTABLE RATE MORTGAGE-BACKED PASS-)
THROUGH CERTIFICATES, SERIES 2005-2,)
Defendants.)

1 On December 18, 2014, I heard oral argument ("Hearing") on the
2 motion for summary judgment ("SJ Motion") filed by plaintiff Stephen P.
3 Arnot, Chapter 7 Trustee ("Trustee"), and the cross-motions for summary
4 judgment ("Cross-Motions") filed by the debtor defendants Michael and
5 Joanne Endresen (the "Endresens") and by the lender defendants, The Bank
6 of New York Mellon (in various capacities) and Green Tree Servicing LLC
7 (collectively, "Lenders"). At the Hearing, I announced a tentative
8 decision followed by an extensive colloquy with counsel for the parties.
9 At the conclusion of the Hearing, I granted the parties until Friday,
10 January 9, 2015, to file supplemental legal memoranda on the issue as to
11 whether a security interest in the personal property proceeds of the
12 settlement of construction defect claims could attach and be perfected
13 under Oregon state law by means other than as provided for in Article 9
14 of the Uniform Commercial Code, as adopted in Oregon ("UCC"). All
15 parties filed supplemental memoranda by the deadline. In addition, on
16 January 9, 2015, the Trustee filed a motion for leave to file a second
17 amended complaint, alleging a new claim based on the theory that any
18 security interest of the Lenders in the proceeds of the settlement is
19 subordinate as to the Trustee. The Lenders objected to the Trustee's
20 motion to further amend the complaint. The Trustee further filed a
21 supplemental authority on January 29, 2015. Thereafter, I took the
22 matter under advisement.

23 In preparing this Memorandum Opinion, I have carefully reviewed
24 the parties' pleadings in this adversary proceeding ("Adversary
25 Proceeding"), the SJ Motion and the Cross-Motions, the parties'
26 supporting legal memoranda, the Declaration of Stephen P. Arnot, and

1 Plaintiff's Concise Statement of Material Facts ("Concise Statement") and
2 the responses by the Endresens and the Lenders to the Concise Statement.
3 The Lenders requested that I take judicial notice ("Judicial Notice
4 Request") of certain public record documents filed with county recorders'
5 offices, pursuant to Federal Rule of Evidence 201. No party objected to
6 the Judicial Notice Request, and I have reviewed the documents specified
7 in the Judicial Notice Request. I further have taken judicial notice of
8 the docket and documents filed in the Adversary Proceeding, in the
9 Endresens' main chapter 7 case, Case No. 11-35396-rlld7, and in the
10 Endresens' currently pending chapter 13 main case, Case No. 11-39658-
11 tmb13, for purposes of confirming and ascertaining facts not reasonably
12 in dispute. Federal Rule of Evidence 201; In re Butts, 350 B.R. 12, 14
13 n.1 (Bankr. E.D. Pa. 2006). In addition, I have reviewed applicable
14 authorities, both as cited to me and as located through my own research.

15 This Memorandum Opinion sets forth my conclusions of law in
16 light of the record before me pursuant to Civil Rule 52(a), applicable in
17 the Adversary Proceeding under Rule 7052.¹

18 I. FACTS

19 The facts in this matter are not in dispute. In October and
20 November 2004, the Endresens purchased ten residential real properties
21 located on N. Columbia Way and N. Oregonian Avenue in Portland, Oregon
22 (the "Properties"), to be used as rentals. All deeds to the Properties
23 were recorded in November 2004. In connection with their purchases of

24 ¹Unless otherwise indicated, all chapter and section references are
25 to the federal Bankruptcy Code, 11 U.S.C. §§ 101-1532, and all "Rule"
26 references are to the Federal Rules of Bankruptcy Procedure. The
Federal Rules of Civil Procedure are referred to as "Civil Rules," and
the Oregon Revised Statutes are referred to as "ORS."

1 the Properties, the Endresens obtained a series of purchase money loans
2 secured by trust deed liens on each of the Properties.

3 The Lender deed of trust ("Trust Deed") in each case is a form
4 instrument designated as "OREGON - Single Family - Fannie Mae/Freddie Mac
5 UNIFORM INSTRUMENT WITH MERS Form 3038 1/01." The Lenders' Trust Deeds
6 apparently have some variations, but the provisions relevant to the
7 issues before me are identical in each of their Trust Deeds.
8 Specifically, among the defined terms in each Trust Deed is
9 "Miscellaneous Proceeds."

10 (N) "Miscellaneous Proceeds" means any compensation,
11 settlement, award of damages, or proceeds paid by any
12 third party . . . for: (i) damage to, or destruction
13 of, the Property; (ii) condemnation or other taking of
all or any part of the Property; (iii) conveyance in
lieu of condemnation; or (iv) misrepresentations of,
or omissions as to, the value and/or condition of the
Property.

14
15 Section 2 of each Trust Deed, entitled "Application of Payments or
16 Proceeds," provides in relevant part:

17 Except as otherwise described in this Section 2, all
18 payments accepted and applied by Lender shall be
19 applied in the following order of priority: (a)
20 interest due under the Note; (b) principal due under
21 the Note; (c) amounts due under Section 3. Such
22 payments shall be applied to each Periodic Payment in
the order in which it becomes due. Any remaining
amounts shall be applied first to late charges, second
to any other amounts due under this Security
Instrument, and then to reduce the principal balance
of the Note.

23 . . .

24 Any application of payments, insurance proceeds, or
25 Miscellaneous Proceeds to principal due under the Note
shall not extend or postpone the due date, or change
the amount, of the Periodic Payments.

1 Section 11 of each Trust Deed, entitled "Assignment of Miscellaneous
2 Proceeds; Forfeiture," provides in relevant part:

3 All Miscellaneous Proceeds are hereby assigned to and
4 shall be paid to Lender.

5 If the Property is damaged, such Miscellaneous
6 Proceeds shall be applied to restoration or repair of
7 the Property, if the restoration or repair is
8 economically feasible and Lender's security is not
9 lessened. During such repair and restoration period,
10 Lender shall have the right to hold such Miscellaneous
11 Proceeds until Lender has had an opportunity to
12 inspect such Property to ensure the work has been
13 completed to Lender's satisfaction, provided that such
14 inspection shall be undertaken promptly. Lender may
15 pay for the repairs and restoration in a single
16 disbursement or in a series of progress payments as
the work is completed. Unless an agreement is made in
writing or Applicable Law requires interest to be paid
on such Miscellaneous Proceeds, Lender shall not be
required to pay Borrower any interest or earnings on
such Miscellaneous Proceeds. If the restoration or
repair is not economically feasible or Lender's
security would be lessened, the Miscellaneous Proceeds
shall be applied to the sums secured by this Security
Instrument, whether or not then due, with the excess,
if any, paid to Borrower. Such Miscellaneous Proceeds
shall be applied in the order provided for in Section
2.

17 In the event of a total taking, destruction, or loss
18 in value of the Property, the Miscellaneous Proceeds
19 shall be applied to the sums secured by this Security
Instrument, whether or not then due, with the excess,
if any, paid to Borrower.

20 . . .

21 The Lenders hold the Trust Deeds on eight of the Properties as
22 successors in interest to the original lenders. No issue has been raised
23 as to the standing of any of the Lenders to appear in this Adversary
24 Proceeding. The deeds of trust as to the remaining two Properties
25 apparently are held by U.S. Bank National Association, as Trustee for
26 Adjustable Rate Mortgage Trust 2005-2, Adjustable Rate Mortgage-Backed

1 Pass-Through Certificates, Series 2005-2 ("U.S. Bank"), which has not
2 appeared in this action, even though the docket reflects that U.S. Bank
3 was properly served with a summons and the Trustee's First Amended
4 Complaint.

5 Apparently, unbeknownst either to the Endresens or to the
6 Lenders, the homes constructed on the Properties had defects in their
7 construction that resulted in significant damage to the Properties over
8 time.

9 The Endresens filed their chapter 7 petition on June 21, 2011.
10 On October 17, 2011, the court entered an order discharging the Endresens
11 and closing their main chapter 7 case as a "no asset estate."

12 On November 9, 2011, the Endresens filed a new chapter 13
13 petition, commencing Case No. 11-39658-tmb13. The Lenders' claims are
14 provided for in the Endresens' confirmed chapter 13 plan and remain
15 unsatisfied.

16 On or about May 8, 2013, the Endresens were added as co-
17 plaintiffs in a civil action pending in Multnomah County Circuit Court
18 entitled Pine River Properties LLC v. GLC Homes, Inc., et al., Case No.
19 1210-13038 (the "State Court Action"). In their complaint in the State
20 Court Action, the Endresens alleged, among other things, that 1)
21 construction of the ten homes on the Properties was completed in 2003, 2)
22 the homes on all ten Properties were negligently constructed, and 3) the
23 Endresens discovered the construction defects in the homes and related
24 damage during the summer in 2012. The Endresens' construction defect
25 claims alleged in the State Court Action are referred to collectively as
26 the "Construction Defect Claims."

1 On February 3, 2014, the court entered an order reopening the
2 Endresens' chapter 7 case. The Trustee was duly appointed as the chapter
3 7 trustee in the Endresens' reopened case. On or about the same date,
4 the Construction Defect Claims were settled for a gross amount of
5 \$318,200.

6 On March 21, 2014, the court entered an order approving the
7 settlement of the Construction Defect Claims. After payment of
8 attorneys' fees and costs, the balance of the settlement proceeds is
9 \$185,525.47 ("Settlement Proceeds"). By agreement among the parties, the
10 Settlement Proceeds are being held in the client trust account of Aldrich
11 Eike, P.C., the law firm that represented the Endresens in the State
12 Court Action, pending resolution in this Adversary Proceeding.

13 The Trustee commenced this Adversary Proceeding by filing a
14 complaint against the Endresens on June 11, 2014. The Endresens filed
15 their initial answer and counterclaim on July 22, 2014. The Trustee
16 filed an answer to the Endresens' counterclaim on the same date.

17 At the initial pretrial conference in the Adversary Proceeding
18 on July 30, 2014, the court granted the Trustee's oral motion to amend
19 the complaint to add the Lenders and U.S. Bank as defendant parties, a
20 ruling that was documented by an order entered on August 1, 2014. The
21 Trustee subsequently filed his First Amended Complaint on July 31, 2014.
22 In the First Amended Complaint, the Trustee sought determinations that
23 the Settlement Proceeds are property of the Endresens' bankruptcy estate,
24 and that the Lenders and U.S. Bank have no enforceable interest in the
25 Settlement Proceeds. The Endresens filed a new answer and counterclaim
26 on August 26, 2014. The Endresens basically denied the Trustee's claims

1 and in their counterclaim sought a determination that the Settlement
2 Proceeds are not property of the estate. The Lenders also filed answers
3 to the Trustee's First Amended Complaint, denying the Trustee's claims
4 based on their opposing claims of superior interests in the Settlement
5 Proceeds. See Docket Nos. 25, 31, 32 and 49. The Trustee filed an
6 Answer to the Endresens' renewed counterclaim on August 26, 2014.

7 U.S. Bank did not respond to the Trustee's First Amended
8 Complaint, and on September 30, 2014, the Trustee applied for entry of
9 default against U.S. Bank. See Docket No. 34. A default order was
10 entered against U.S. Bank in the Adversary Proceeding on October 1, 2014.
11 See Docket No. 37.

12 The Trustee filed his SJ Motion on October 6, 2014. After a
13 scheduling conference at which deadlines for cross-motions, responses and
14 replies and the Hearing date were discussed, a Summary Judgment
15 Scheduling Order was entered on October 27, 2014. See Docket Nos. 51 and
16 53. Thereafter, the Cross-Motions, responses and supporting papers, and
17 a reply were filed according to the timetable set in the Summary Judgment
18 Scheduling Order. As noted above, after a lively discussion at the
19 Hearing, I gave the parties time to file supplemental memoranda with
20 respect to a limited issue(s) by January 9, 2015. All parties availed
21 themselves of that opportunity. See Docket Nos. 75, 76 and 78. I have
22 taken the SJ Motion and Cross-Motions under advisement.

II. JURISDICTION

24 I have jurisdiction to decide the SJ Motion and the Cross-
25 Motions under 28 U.S.C. §§ 1334, 157(b)(1) and 157(b)(2)(A), (B), (C),
26 (K) and (O).

III. DISCUSSION

A. Summary Judgment Standards

Under Civil Rule 56(a), applicable under Rule 7056, summary judgment is appropriate when "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Since all material facts in the matters before me are undisputed, deciding the SJ Motion and the Cross-Motions by resolving questions of law only is appropriate.

B. Property of the Estate

The Trustee argues that the Settlement Proceeds are property of the Endresens' bankruptcy estate because, although the Endresens did not discover the claims they asserted in the State Court Action until the summer of 2012, postpetition, the Construction Defect Claims, ultimately resulting in there being Settlement Proceeds, arose in 2003 when the residences on the Properties were constructed, many years prepetition.

The term "property of the estate" under § 541 is very broad. It generally includes "all legal or equitable interests of the debtor in property as of the commencement of the case." § 541(a)(1). That includes claims or causes of action in litigation, including tort claims. Sierra Switchboard Co. v. Westinghouse Elec. Corp., 789 F.2d 705, 707 (9th Cir. 1986), citing United States v. Whiting Pools, Inc., 462 U.S. 198, 205 & n.9 (1983); Goldstein v. Stahl (In re Goldstein), Opinion in BAP No. CC-14-1346-TaDPA (9th Cir. BAP March 3, 2015). It also generally includes "[p]roceeds, product, offspring, rents, or profits of or from property of the estate" (§ 541(a)(6)) and "[a]ny interest in property that the estate acquires after the commencement of the case" (§ 541(a)(7)). The breadth

1 of the concept of property of the estate in the Bankruptcy Code reflects
2 the intention of Congress "to include all legally cognizable interests
3 although they may be contingent and not subject to possession until some
4 future time." Rau v. Ryerson (In re Ryerson), 739 F.2d 1423, 1425 (9th
5 Cir. 1984), citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 175-76
6 (1977), reprinted in 1978 U.S. Code Cong. & Ad. News 5963, 6136. As
7 conceded by the Endresens, the purpose of the expansive reach of
8 "property of the estate" is to ensure that anything of value claimed by
9 the debtor can be liquidated and distributed to maximize the creditors'
10 recovery. See Defendants Michael and JoAnne Endresen's Memorandum in
11 Opposition to Plaintiff's Motion for Summary Judgment and in Support of
12 Cross-Motion for Summary Judgment ("Endresens' Opposition Memorandum"),
13 at 5-6.

14 However, relying on Oregon state law, the Endresens argue that
15 the Construction Defect Claims did not "accrue" until they discovered
16 them postpetition, and, consequently, the Settlement Proceeds, as a
17 product of the resolution of claims that arose postpetition, are not
18 property of the estate. I disagree for the following reasons.

19 "Property interests are created and defined by state law."
20 Butner v. United States, 440 U.S. 48, 55 (1979). However, what is
21 property of a bankruptcy estate ultimately is a matter to be determined
22 under federal law. Sierra Switchboard Co. v. Westinghouse Elec. Corp.,
23 789 F.2d at 708-09 ("By adopting a comprehensive definition of property,
24 the Bankruptcy Reform Act reduced the bankruptcy court's cumbersome
25 reliance on state law analysis for determining property to be included in
26 the estate.").

1 The Endresens cite three Oregon appellate decisions in support
2 of their argument that the Construction Defect Claims did not "accrue"
3 until after their chapter 7 filing. See Abraham v. T. Henry Const.,
4 Inc., 350 Or. 29, 249 P.3d 534 (2011); Berry v. Branner, 245 Or. 307, 421
5 P.2d 996 (1966); and Tavtigian-Coburn v. All Star Custom Homes, LLC, 266
6 Or. App. 220, 337 P.3d 925 (2014). The decision in Berry v. Branner
7 focused on the definition of the word "accrued" in the context of
8 Oregon's general limitations statute, ORS 12.010, and concluded that the
9 limitations period did not begin to run until the subject medical
10 malpractice claim was discovered or reasonably should have been
11 discovered. 245 Or. at 312-16, 421 P.2d at 998-1000. The Abraham and
12 Tavtigian-Coburn decisions stand for the same principle: tort claims do
13 not "accrue" under Oregon law for limitations purposes until the claimant
14 is aware or reasonably should be aware of them. Abraham, 350 Or. at 34
15 n.3, 249 P.3d at 536 n.3; Tavtigian-Coburn, 266 Or. App, at 221, 337 P.3d
16 at 926.

17 Generally, to determine when a claim accrues, a bankruptcy
18 court looks to state law. Cusano v. Klein, 264 F.3d 936, 947 (9th Cir.
19 2001). "It is important, however, to distinguish principles of accrual
20 from principles of discovery and tolling, which may cause the statute of
21 limitations to begin to run after accrual has occurred for purposes of
22 ownership in a bankruptcy proceeding." Id., citing State Farm Life Ins.
23 Co. v. Swift (In re Swift), 129 F.2d 792, 796, 798 (5th Cir. 1997).

24 The accrual of a cause of action is a concept closely
25 tied to the fundamental purpose of a cause of action -
26 to make an injured party whole. Damages, then, are a
prerequisite to a cause of action. Without damages,
there is no injury to remedy.

1 The purpose of statutes of limitation is different:
2 they bar the litigation of stale claims at a time
3 removed from when the pertinent events occurred. The
4 concept of accrual is important to the statute of
5 limitations because accrual sets the clock in motion.
6 But the running of the statute of limitations is
7 influenced by more than just the concept of accrual.
8 In this connection, to avoid harsh and unfair
9 consequences that may result from the premature
10 running of the statute of limitations, Texas [like
11 Oregon] adopted the "discovery" rule. Under this
12 rule, the statute of limitations does not begin to run
13 until the injured party "discovers" or with the
14 exercise of reasonable care and diligence should have
15 discovered that a particular injury has occurred. The
16 result is that the statute of limitations may begin to
17 run on a date other than that on which the suit could
18 first be maintained. A classic example illustrates
19 this. Consider a case of medical malpractice in which
20 the treating physician has left a dangerous metal
21 instrument inside the body of his patient [exactly as
22 occurred in Berry v. Branner]. At the time the doctor
23 finishes the surgery, the doctor has completed a tort.
24 He has violated a legal duty owed to the patient, and
25 the patient was injured by that violation. If the
 patient instituted suit at this moment, his suit would
 be viable. The statute of limitations has not begun
 to run, however. Under the discovery rule, the
 statute of limitations is tolled until the patient
 either discovers or should have discovered that an
 injury has occurred. This example shows that the
 dates of accrual and the start of the running of the
 statute of limitations may vary greatly.
 Unfortunately, many cases applying the principles of
 the discovery rule are written in terms of accrual.

19 . . .
20 We are determining when the causes of action accrued
21 for purposes of ownership in a bankruptcy proceeding.
22 The time of discovery of the injury is not relevant to
23 this inquiry. A cause of action can accrue for
24 ownership purposes before the statute of limitations
25 for that cause of action has begun to run. Our focus,
 then, is upon the moment the injury occurred. The
 three statute of limitations cases cited are not
 helpful in this case [or in this one] because of their
 reliance upon discovery.

26 Id. See Tyler v. DH Capital Management, Inc., 736 F.3d 455, 462 (6th

1 Cir. 2013):

2 [A]ll causes of action that hypothetically could have
3 been brought pre-petition are property of the estate.
4 Bd. Of Trustees of Teamsters Local 683 Pension Fund v.
5 Foodtown, Inc., 296 F.3d 164, 169 n.5 (3d Cir. 2002).
6 This is the case "even if the debtor[] w[as] unaware
7 of the claim." In re Michael, 423 B.R. 323, 330
8 (Bank. D. Idaho 2009); see also Blakely v. Alvarez (In
9 re Alvarez), 224 F.3d 1273, 1276 n.7.

10 Id. at 463 ("[A]ccrual for the purposes of § 541 is different from
11 accrual for statute-of-limitations purposes."), citing In re Swift, 129
12 F.3d at 798. "[I]f a claim 'could have been brought,' it has accrued."
13 In re Goldstein, Opinion in BAP No. CC-14-1346-TaDPA (9th Cir. BAP March
14 3, 2015), quoting In re Cusano, 264 F.3d at 947.

15 In determining whether assets are "prepetition" assets that are
16 owned by the estate or "postpetition" assets that should be recognized as
17 the debtor's, free of estate claims, the touchstone is the Supreme
18 Court's Bankruptcy Act decision in Segal v. Rochelle, 382 U.S. 375
19 (1966). In Segal, the Supreme Court confronted the question of who owned
20 a loss carryback tax refund claim arising from losses generated during
21 the year of the bankruptcy filing, the estate or the debtors. Id. at
22 376. Ultimately, the Supreme Court determined that the refund claim was
23 estate property based on its conclusions that the claim was "sufficiently
24 rooted in the pre-bankruptcy past and [was] little entangled with the
25 bankrupts' ability to make an unencumbered fresh start." Id. at 380.
26 The Bankruptcy Code "followed Segal to the extent that it includes after
acquired property 'sufficiently rooted in the pre-bankruptcy past' but
eliminates the requirement that it not be entangled in the debtor's
ability to make a fresh start." In re Richards, 249 B.R. 859, 861

1 (Bankr. E.D. Mich. 2000), citing S. Rep. No. 95-989, 95th Cong., 2d Sess.
2 82, 1978, reprinted in 1978 U.S.C.C.A.N. 5787, 5868; In re Ryerson, 739
3 F.2d at 1425; and Johnson v. Taxel (In re Johnson), 178 B.R. 216, 218
4 (9th Cir. BAP 1995).

5 In this case, the Construction Defect Claims, that ultimately
6 came to fruition as the Settlement Proceeds, arose when residences were
7 constructed on the Properties, and the Endresens purchased them, years in
8 advance of the Endresens' chapter 7 bankruptcy filing. Construction
9 defect claims, of course, by their nature arise from defective
10 construction. The fact that the Endresens' claims were not discovered
11 until 2012, after their chapter 7 case had been filed and closed, with a
12 discharge order entered, is merely fortuitous, likely an artifact of the
13 facts that the properties were rentals and the Endresens were absentee
14 landlords. See, e.g., In re Richards, 249 B.R. at 861 ("All of the
15 allegedly wrongful conduct giving rise to the debtor's claim occurred
16 prepetition, and indeed more than twenty-five years prepetition.
17 Further, although the diagnosis was made seven months after the petition
18 was filed, that timing appears to have been more a result of happenstance
19 than of medical necessity.").

20 Based on the foregoing analysis, I conclude that the damages
21 from the Construction Defect Claims, and thus, the Settlement Proceeds,
22 are sufficiently rooted in the Endresens' pre-bankruptcy past to
23 constitute property of the Endresens' bankruptcy estate.

24 Having determined that the Settlement Proceeds are chapter 7
25 estate assets, I move on to consider the competing claims of the Trustee
26 and the Lenders to the Settlement Proceeds.

1 C. Outright Assignment v. Assignment for Security Purposes

2 In their opposition memorandum, the Endresens argue that
3 section 11 of the Trust Deeds provides for an assignment and thus an
4 "absolute transfer" of Miscellaneous Proceeds rather than creating a mere
5 security interest in such proceeds. See Endresens' Opposition
6 Memorandum, at 11-12. See, e.g., In re Leiferman, Case No. 10-40718
7 (Bankr. D.S.D. Jan. 19, 2011):

8 Debtors did not grant Wells Fargo a security interest
9 in the miscellaneous proceeds. Debtors instead
10 **assigned** those proceeds to Wells Fargo The
11 assignment may well operate to protect Wells Fargo
12 from loss in the event Debtors' real property is
condemned, damaged or destroyed However, the
Court will not deem the assignment to be a security
interest on that basis alone in the absence of
language in the mortgage clearly indicating that was
the parties' intent. (Emphasis added.)

13 The Endresens' argument is undercut by the language of specific
14 provisions in the Trust Deeds.

15 The first sentence of section 11 of the Trust Deeds does
16 provide that, "All Miscellaneous Proceeds are hereby assigned and shall
17 be paid to Lender." However, section 11 continues, to set forth detailed
18 arrangements for the application of Miscellaneous Proceeds to
19 "restoration or repair" of the Properties, and if such restoration or
20 repair is not economically feasible "or Lender's security would be
21 lessened," Miscellaneous Proceeds are to be "applied to the sums secured"
22 by the Trust Deeds, "with the excess, if any, paid to Borrower."
23 Miscellaneous Proceeds are to "be applied in the order provided for in
24 Section 2." In the event of total destruction or loss of value of the
25 Properties, Miscellaneous Proceeds are to be applied "to the sums
26 secured" by the Trust Deeds, "with the excess, if any, paid to Borrower."

1 Section 2 of the Trust Deeds sets forth detailed instructions
2 for the application of all payments, including Miscellaneous Proceeds, to
3 amounts owed by the Endresens under the Trust Deeds, including interest
4 and principal, consistent with the schedule of Periodic Payments due.

5 If any Miscellaneous Proceeds were transferred outright to the
6 Lenders, not as a security arrangement, there would be no need for
7 specifying such detailed and restrictive payment arrangements.
8 Certainly, there would be no need for language providing for the payment
9 of any excess funds beyond "sums secured by this Security Instrument" to
10 the Borrower.

11 Based on the language of the Trust Deeds, I conclude that the
12 Trust Deeds provide for an assignment of Miscellaneous Proceeds for
13 security purposes, creating, in effect, a security agreement, rather than
14 an assignment outright.

15 D. The Description of "Miscellaneous Proceeds" in the Trust Deeds

16 The Trustee argues that the definition of "Miscellaneous
17 Proceeds" in the Trust Deeds does not satisfy the test of ORS 79.0108(1),
18 requiring that a secured party's collateral be "reasonably identified,"
19 on two primary grounds.² At the outset, I do not agree that the Trust
20 Deeds were designed to create a security interest in personal property
21 under Article 9 of the UCC, as discussed in detail infra. However,
22 operating under the assumption that in creating a security arrangement
23 for repayment of a debt, the collateral securing repayment must be
24 reasonably identified as a matter of general contract interpretation, I

26 ²ORS § 79.0108(1) provides in relevant part: "[A] description of
personal . . . property is sufficient, whether or not it is specific, if
it reasonably identifies what is described."

consider the Trustee's arguments.

First, the Trustee argues that the Settlement Proceeds are the product of resolution of commercial tort claims that are not described specifically or at all in the definition of "Miscellaneous Proceeds" in the Trust Deeds. The response to that argument is the Construction Defect Claims were settled, resulting in the Settlement Proceeds, months in advance of the filing of the Adversary Proceeding. In other words, when the Adversary Proceeding was commenced, there were no outstanding Construction Defect Claims, characterized as "commercial tort claims" or otherwise. All we ever have been dealing with in this Adversary Proceeding is the Settlement Proceeds. Accordingly, the relevant question here is whether the definition of "Miscellaneous Proceeds" in the Trust Deeds reasonably identifies the Settlement Proceeds as subject to the Lenders' alleged secured claim.

The Trustee argues that it does not, but I disagree. The definition of "Miscellaneous Proceeds" in the Trust Deeds includes the following: "'Miscellaneous Proceeds' means any compensation, settlement, award of damages, or proceeds paid by any third party . . . for (i) damage to, or destruction of, the Property . . ." (Emphasis added.) Recall that the State Court Action included the Endresens' claims that the homes on the Properties were negligently constructed, resulting in damages from their construction defects. Those claims were settled, resulting in the Settlement Proceeds. Using the Trustee's argument from ORS 79.0108(2)(f),³ by analogy, collateral is reasonably identified if

³ORS § 79.0108(2)(f) provides, in relevant part: "[A] description of collateral reasonably identifies the collateral if it identifies the (continued...)

1 "the identity of the collateral is objectively determinable" from the
2 description used. I conclude that the definition of Miscellaneous
3 Proceeds in the Trust Deeds provides an adequate description of the
4 Settlement Proceeds as a settlement or proceeds paid by a third party for
5 damage to the Properties.

6 E. Interpretation of § 552 in this Context

7 The Trustee argues that § 552 operates to abrogate any secured
8 interest of the Lenders in the Settlement Proceeds that might have been
9 recognized outside of bankruptcy. The subsections of § 552 that concern
10 us are § 552(a) and § 552(b)(1). § 552(a) provides:

11 Except as provided in subsection (b) of this section,
12 property acquired by the estate or by the debtor after
13 the commencement of the case is not subject to any
lien resulting from any security agreement entered
into by the debtor before the commencement of the
case. (Emphasis added.)

15 With exceptions not relevant to the decision in this matter, § 552(b)(1)
16 provides:

17 [I]f the debtor and an entity entered into a security
18 agreement before the commencement of the case, and if
the security interest created by such security
agreement extends to property of the debtor acquired
19 before the commencement of the case and to proceeds,
products, offspring, or profits of such property, then
such security interest extends to such proceeds,
products, offspring, or profits acquired by the estate
20 after the commencement of the case to the extent
provided by such security agreement and by applicable
nonbankruptcy law, except to any extent that the
court, after notice and a hearing and based on the
equities of the case, orders otherwise. (Emphasis
added.)

25
26 ³(...continued)
collateral by: . . . any other method, if the identity of the collateral
is objectively determinable."

1 Initially, the Trustee argues that the Construction Defect
2 Claims "did not accrue (or come into existence)" under Oregon law until
3 after the Endresens filed their chapter 7 petition, making the
4 Construction Defect Claims and the resulting Settlement Proceeds "after-
5 acquired property" for purposes of § 541(a)(7). Since I just arrived at
6 a contrary conclusion in determining the "property of the estate" issue,
7 see pages 10-15 supra, I reject that argument. However, I do recognize
8 that the Settlement Proceeds came into existence postpetition; so, I
9 agree that § 552(a) applies. I do not understand Lenders to argue
10 otherwise. The real question is whether the "proceeds" exception in
11 § 552(b)(1) likewise applies.

12 i) Attachment

13 The Trustee argues that the Lenders' security interest in the
14 Settlement Proceeds, if any, could not "attach" to the Settlement
15 Proceeds, as after-acquired property, until the subject settlement of the
16 Construction Defect Claims was negotiated postpetition and thus fails in
17 light of the provisions of § 552(a). In opposition, the Lenders cite
18 Wiersma v. O.H. Kruse Grain and Milling (In re Wiersma), 324 B.R. 92 (9th
19 Cir. BAP 2005), rev'd on jurisdictional grounds, 483 F.3d 933 (9th Cir.
20 2007).

21 In Wiersma, the debtors were dairy farmers who had obtained a
22 loan from Bank of the West secured by their dairy herd and general
23 intangibles, among other things, including "all proceeds and products of
24 the collateral including, but not limited to, the proceeds of any
25 insurance thereon." Id., 324 B.R. at 99. Unfortunately, faulty wiring
installed at the debtors' dairy facilities caused electrical shocks to

1 the cows that made them sick and resulted in their deaths. Ultimately,
2 the debtors' entire 2000-head dairy herd was lost. In September 2000,
3 the debtors sued their electrical contractor in state court for their
4 damages caused by the faulty wiring, asserting tort and breach of
5 contract claims. Id.

6 The financial reverses suffered from the loss of their dairy
7 herd precipitated a chapter 11 bankruptcy filing by the debtors in
8 October 2001. In 2002, the debtors negotiated a settlement of their
9 claims in the state court litigation, resulting in net proceeds to their
10 estate of approximately \$1.6 million. Id. at 100. Bank of the West
11 claimed the net settlement proceeds as its cash collateral.

12 The debtors filed a motion under § 506(a) to obtain a
13 determination that Bank of the West did not have a security interest in
14 the net settlement proceeds, as their state court claims "sounded in
15 tort, and UCC Article 9 excluded tort claims from the 'general
16 intangibles' category." Id. Bank of the West argued that the net
17 settlement proceeds were either "general intangibles" or proceeds of its
18 dairy herd collateral, and in either case, it had a valid security
19 interest in the net settlement proceeds. Id.

20 Following a hearing, the bankruptcy court ruled in favor of
21 Bank of the West on alternative grounds: First, the bankruptcy court
22 characterized the debtors' lawsuit as a contract action, with the result
23 that Article 9 applied to give Bank of the West a security interest in
24 the net settlement proceeds as either "general intangibles" or
25 "accounts." In the alternative, the bankruptcy court held that the net
26 settlement proceeds constituted "proceeds" of the bank's livestock

1 collateral. Id.

2 On appeal, the Bankruptcy Appellate Panel ("BAP") concluded
3 that under the current revised version of Article 9 of the UCC, Bank of
4 the West had a valid security interest in the net settlement proceeds as
5 an "after-acquired" payment intangible. Id. at 106-07. However, the BAP
6 also affirmed the bankruptcy court on an alternative ground: "It is clear
7 that rights arising from loss or damage to collateral are 'proceeds,'
8 whether or not insurance covers the loss." Id. at 108. The rationale
9 for the BAP's holding was that the Ninth Circuit had held that the term
10 "proceeds" was to be given the "broadest possible definition," and it
11 made no difference that the loss of the dairy herd occurred prepetition,
12 while the debtors' lawsuit was not resolved and the net settlement
13 proceeds were not realized until postpetition. See, e.g., Fifteenth RMA
14 Partners, L.P. v. Pac./West Communications Group, Inc. (In re Pac./West
15 Communications Group, Inc., 301 F.3d 1150, 1153-55 (9th Cir. 2002) ("The
16 classic situation is that of a tort recovery obtained by a debtor for
17 damage to secured property; the secured creditor obtains a lien on such a
18 payment to replace the diminished value of the security.'"), quoting
19 McGonigle v. Combs, 968 F.2d 810, 828 (9th Cir. 1992).

20 While the precedential effect of the BAP's decision in Wiersma
21 is vitiated by the subsequent reversal on jurisdictional grounds by the
22 Ninth Circuit, I find the reasoning of Wiersma persuasive, particularly
23 in light of the cited consistent Ninth Circuit authorities. See also In
24 re Encinas, 27 B.R. 79, 80-81 (Bankr. D. Or. 1983):

25 All of the above subsections of § 541 must be read in
26 conjunction with 11 U.S.C. § 552(b) which provides
that where a debtor and a secured party enter into a
security agreement prior to commencement of the case

1 and that agreement covers the proceeds of collateral,
2 then such security interest extends to such proceeds
3 acquired by the estate after the commencement of the
case to the extent provided by such security agreement
and by applicable nonbankruptcy law.

4 I conclude that the Lenders' security interest in the
5 Settlement Proceeds attached by virtue of the security arrangements for
6 the assignment of Miscellaneous Proceeds in the Trust Deeds. I reject
7 Trustee's argument that the Lenders' failure to have an identifiable,
8 properly attached and perfected security interest in the Construction
9 Defect Claims, as commercial tort claims, at the intermediate stage prior
10 to settlement of the Construction Defect Claims automatically vitiates
11 the Lenders' security interest in the Settlement Proceeds vis-a-vis the
12 estate, as inconsistent with the foregoing authorities.

13 Accordingly, while I recognize that the Settlement Proceeds
14 constitute postpetition estate property for purposes of § 552(a), I
15 further conclude that the Settlement Proceeds are identifiable
16 Miscellaneous Proceeds under the Trust Deeds to which Lenders' security
17 interests attach for purposes of § 552(b), as "proceeds" of the Lenders'
18 collateral. However, that conclusion does not end the inquiry because
19 attachment alone does not necessarily trump the Trustee's entitlement to
20 the Settlement Proceeds. The question then becomes whether the Lenders'
21 security interest in the Settlement Proceeds is, or is required to be,
22 perfected.

23 ii) Perfection

24 Typically, under the UCC, in order to perfect a security
25 interest in personal property, such as the Settlement Proceeds, a
26 financing statement must be filed. See ORS § 79.0310. In this case, it

1 is uncontested that, although the Trust Deeds were recorded, no UCC-1
2 financing statements have been filed to perfect the Lenders' secured
3 interests in Miscellaneous Proceeds, such as the Settlement Proceeds.
4 This is the issue that the Trustee seeks to highlight in his proposed
5 second amended complaint. However, the question of perfection is
6 embedded in the claims asserted in the Trustee's First Amended Complaint
7 against the Lenders, and it is implicated in the SJ Motion and Cross-
8 Motions that I am deciding. That is precisely why I gave the parties the
9 opportunity to submit further legal memoranda at the Hearing to address
10 the question of whether a valid security interest in the Settlement
11 Proceeds could be created under Oregon law without satisfying the normal
12 perfection requirements of the UCC.

13 The answer to that question, somewhat surprisingly, is provided
14 by provisions of the UCC itself. ORS § 71.3020(1) provides that, "Except
15 as otherwise provided in subsection (2) of this section or elsewhere in
16 the [UCC], the effect of provisions of the [UCC] may be varied by
17 agreement." In analyzing a predecessor provision to ORS § 71.3020(1),
18 one commentator affirms that "the freedom of contract is not without
19 limits," but notes that several Oregon decisions have given effect to
20 agreements that vary UCC provisions. Henry J. Bailey III, Oregon Uniform
21 Commercial Code Vol. 1, § 1.5, at 10 (1982 ed.). See, e.g., Can-Key
22 Indus., Inc. v. Indus. Leasing Corp., 286 Or. 173, 593 P.2d 1125 (1979)
23 (varying the UCC's provision for buyer's acceptance of goods sold); and
24 Northwest Lumber Sales, Inc. v. Continental Forest Prods., Inc., 261 Or.
25 480, 495 P.2d 744 (1972) (varying the UCC provision on adequate assurance
26 of performance with respect to a sales contract).

1 In ORS Chapter 79, which contains the UCC provisions with
2 respect to secured transactions, ORS § 79.0201 provides that, "Except as
3 otherwise provided in the [UCC], a security agreement is effective
4 according to its terms between the parties, against purchasers of the
5 collateral, and against creditors [such as the Trustee in this case]."
6 (Emphasis added.)

7 ORS § 79.0315(3) provides that, "A security interest in
8 proceeds is a perfected security interest if the security interest in the
9 original collateral was perfected." (Emphasis added.) The original
10 collateral here is the Properties. The Settlement Proceeds are proceeds
11 resulting from damage to the Properties, as discussed at page 17 supra.
12 The Lenders' security interest in the Properties was perfected by the
13 recordation of the Trust Deeds in 2004. Article 9 of the UCC does not
14 apply to the assignment of Miscellaneous Proceeds for security purposes
15 in the Lenders' Trust Deeds. However, even if Article 9 of the UCC did
16 apply, under ORS § 79.0315(3), the Lenders were not required to file a
17 financing statement to perfect their security interest in the Settlement
18 Proceeds as proceeds of their collateral.

19 In support of his position, the Trustee has cited a law review
20 article, G. Ray Warner, "Article 9's Bankrupt Proceeds Rule: Amending
21 Bankruptcy Code Section 552 Through the UCC 'Proceeds' Definition," 46
22 Gonz L. Rev. 521 et seq. (2011). The premise of the article is that
23 expansion of the definition of "proceeds" in the Uniform Commercial Code
24 was an improper and unwarranted effort by secured creditor advocates to
25 alter bankruptcy outcomes in their favor without in any way expanding the
26 scope of lending. Id. at 521-24. Concern in the article focuses on "new

1 classes" of proceeds, including "income received by the debtor for
2 leasing or licensing the collateral" and "'rights arising out of
3 collateral.'" Id. at 522. The article does not address its concerns to
4 "proceeds" resulting from damage or loss of value to a secured creditor's
5 collateral, as we deal with in this case. And, the article notes the
6 following, consistent with ORS § 79.0315(3), as just described:

7 Other significant nonbankruptcy consequences of
8 labeling collateral as proceeds are the automatic
perfection and related priority rules. These rules
generally provide that, if the original collateral was
perfected, its proceeds are perfected automatically
and enjoy the same priority date as the original
collateral.

11 Id. at 523-24. (Emphasis added.)

12 While I sympathize with the concerns expressed in Professor
13 Warner's article, I do not find them to be applicable to the decisions I
14 need to make in this case.

15 The Trust Deeds are not standard form personal property
16 security agreements, but the provisions of the Trust Deeds concerning
17 assignment of Miscellaneous Proceeds function as a security agreement and
18 create a valid security interest that attached to the Settlement
19 Proceeds. Based on my analysis of provisions of the UCC, as set forth
20 above, even if applicable, which I conclude is not the case, no
21 additional action, including the filing of a financing statement(s), was
22 required to perfect the Lenders' security interest in the Settlement
23 Proceeds. Accordingly, I conclude that the exception to application of
24 § 552(a) provided for in § 552(b)(1) applies to establish that the
25 Lenders have a valid, persisting security interest in the Settlement
26 Proceeds as proceeds of their collateral, entitling the Lenders to

1 summary judgment in their favor on their Cross-Motions. Leaving no issue
2 unresolved that the Trustee seeks to raise in a second amended complaint,
3 I will deny the Trustee's motion to file a second amended complaint.

4 F. U.S. Bank Judgment

5 As noted above, U.S. Bank did not respond to the Trustee's
6 First Amended Complaint, and a default order has been entered. At the
7 Hearing, counsel for the Endresens noted that U.S. Bank's Trust Deeds
8 have the same provisions relating to assignment of Miscellaneous Proceeds
9 as are contained in the Lenders' Trust Deeds, and accordingly, U.S. Bank
10 should be entitled to the benefits of the same analysis applied under
11 § 552 as benefit the Lenders.

12 I disagree for the following reasons. The Lenders have
13 participated actively and eloquently in supporting their positions in
14 this litigation, at the expenditure of great time and effort, and
15 resulting costs, of their counsel. U.S. Bank has not even appeared,
16 although it was properly served with the First Amended Complaint. I have
17 concluded that the Lenders' position is supported by the exception to the
18 application of § 552(a) included in § 552(b)(1). However, following the
19 substantive provision in § 552(b)(1) protecting secured creditors'
20 interests in proceeds is a further exception to the application of
21 § 552(b)(1): "except to any extent that the court, after notice and a
22 hearing and based on the equities of the case, orders otherwise." In
23 this situation, I do not find that "the equities of the case" mandate
24 that U.S. Bank benefit as a free rider from the efforts expended by the
25 Lenders. U.S. Bank had ample opportunity to appear and defend its
26 interest, if any, in the Settlement Proceeds, and it chose not to do so.

I will enter a default judgment in favor of the Trustee and against U.S. Bank on the First Amended Complaint.

Conclusion

Based on the foregoing conclusions, I will grant summary judgment in favor of the Trustee and against the Endresens and the Lenders on the property of the estate issue, but I will grant summary judgment in favor of the Lenders and against the Trustee with respect to the existence and continuing validity of the Lenders' secured interest in the Settlement Proceeds and the impact of § 552. I will enter a default judgment in favor of the Trustee and against U.S. Bank on the Trustee's First Amended Complaint. The effective split of the \$185,525.47 total Settlement Proceeds is 80% (\$148,420.37) to the Lenders and 20% (\$37,105.10) to the Trustee. The parties should submit orders and judgments consistent with this Memorandum Opinion within ten days following the date of its entry. The court will enter the order denying the Trustee's motion to file a second amended complaint.

##

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